

Vote Record

Committee on Agriculture, Financial Institutions and Insurance

Date: April 22, 2003

Moved by: Hansen

Seconded by: Kedzie

AB _____ SB 116 Clearinghouse Rule _____

AJR _____ SJR _____ Appointment, _____

AR _____ SR _____ Other _____

A/S Amdt _____

A/S Amdt _____ to A/S Amdt _____

A/S Sub Amdt _____

A/S Amdt _____ to A/S Sub Amdt _____

A/S Amdt _____ to A/S Amdt _____ to A/S Sub Amdt _____

Be recommended for:

- ☒ Passage ☐ Adoption ☐ Confirmation ☐ Concurrence ☐ Indefinite Postponement
☐ Introduction ☐ Rejection ☐ Tabling ☐ Nonconcurrence

Committee Member

Senator Dale Schultz

Senator Ronald Brown

Senator Neal Kedzie

Senator Judith Robson

Senator David Hansen

<u>Aye</u>	<u>No</u>	<u>Absent</u>	<u>Not Voting</u>
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Totals: _____



The Hamilton Consulting Group

Legislative, Regulatory & Information Services

April 22, 2003

TO: Members of the Senate Committee on Agriculture, Financial Institutions and Insurance

FR: Andy Franken, Reinsurance Association of America

RE: Support for Senate Bill 116

The Issues:

The amendment clarifies existing language to ensure that the intent of the current statute is met with regard to utilization of cut through and assumption liability agreements. Because of adverse court decisions in other jurisdictions, the amendment is desirable to ensure that current law is not similarly misinterpreted. Clarification assures marketplace competition since cut throughs allow some insurers to compete for business that otherwise would be beyond their reach. Adopting this bill's clarifying language will create certainty that agreements will be honored in the event the insurance company becomes insolvent.

Adopting the amendments will:

- ***Recognize that the liquidator of insolvent insurance companies will recognize and honor cut through and assumption liability agreements;***
- ***Enable small domestic insurance companies to compete with large local and national carriers;***
- ***Enable small domestic insurance companies to compete with non-domestic companies whose domestic states' laws already have similar provisions;***
- ***Address consumer needs by providing a greater choice of insurance carriers, increasing capacity, thus impacting availability and affordability;***
- ***Conform state law with the laws of the majority of the states;***
- ***Clarify that the law does not intend to put reinsurers at risk of paying twice in the event that a cut through clause is used.***

Cut Through Background

A cut through is a clause added to an insurance policy to provide that, in the event of the insolvency of the insurance company, the amount of any loss which would have been recovered from the reinsurer by the insurance company will be paid instead directly to the policyholder by the reinsurer. Cut throughs had their origin in the need for mortgage lenders to have assurance that the insurer writing a homeowners' policy could stand behind its obligations. The mortgage companies, and later the secondary mortgage markets, instituted rules which required an insurer of a mortgaged home to meet certain financial standards or have a specified rating by an insurer rating service. Often, small insurers or new insurers could not qualify and, thus, were shut out of the homeowners' market. Reinsurers, which were willing to stand behind the insurers via the use of a cut through, responded to the mortgage lenders' concerns. The banks were satisfied that the larger and favorably rated reinsurer was a sufficient financial strength to protect the collateral. The common market effect of the existence of cut throughs is to encourage competition among insurers by ensuring that additional insurers can compete for business. A similar parallel exists with surety companies which protect public works projects where Federal financial requirements are imposed on surety companies. If a reinsurer issues a cut through, it has a contractual obligation to pay the beneficiary of the cut through. It also could have the obligation to pay the same proceeds to the receiver. This bill clarifies that the reinsurer's obligation is to pay the claim only once.

The use of a cut through enables insureds to utilize the financial strength of large, financially secure reinsurers. Some clients require insurers to obtain a cut through or face the possibility of losing business to a larger or non-domestic insurance company. Reinsurers usually only provide cut throughs if an underlying insured and insurer request one. Business could be lost by domestic insurers to non-domestic insurers because most states recognize cut throughs for all lines of business.

The following states in recent years have adopted improved, related provisions: Arizona, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Idaho, Indiana, Iowa, Kansas, Louisiana, Maine, Michigan, Minnesota, Nebraska, Nevada, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, South Carolina, Texas, Vermont, Virginia and Washington.